

From: Johnson Bradford A
Sent: Friday, March 29, 2002 7:10 AM
To: Piucci John A
Cc: Boulanger Raymond M
Subject: FW: [REDACTED] NSAR

John, here is the advice we got. Hope this settles the issue. Please let us know if you need additional assistance. Have a Happy Holiday.

-----Original Message-----

From: Bernstein Jamie G
Sent: Thursday, March 28, 2002 4:53 PM
To: Johnson Bradford A; Boulanger Raymond M
Cc: Trice Ashton P
Subject: [REDACTED] NSAR

We have reviewed your memorandum dated March 18, 2001 regarding the statutory basis for recapturing a foreign tax credit that was generated in [REDACTED] but carried back and applied in [REDACTED]. It is our understanding that the taxpayer filed an income tax return for [REDACTED] showing "excess" foreign income taxes paid or accrued in [REDACTED] (i.e., foreign income taxes in excess of the taxpayer's section 904(a) limitation for [REDACTED] and, thus, not allowable as a credit in [REDACTED]). On [REDACTED], the taxpayer filed a Form 1120X for [REDACTED], carrying back to [REDACTED] \$[REDACTED] of the excess foreign income taxes paid or accrued in [REDACTED]. Because Appeals had jurisdiction over the taxpayer's [REDACTED] tax year at the time the taxpayer filed the Form 1120X for [REDACTED], the Form 1120X was forwarded to Appeals. Appeals recommended allowance of the carryback and the carryback was allowed. Subsequently, it was determined that the amount of foreign taxes paid or accrued for [REDACTED] did not exceed the amount of the taxpayer's section 904(a) limitation for [REDACTED]. As a result, the taxpayer was allowed to claim a credit in [REDACTED] for the \$[REDACTED] of foreign income taxes the taxpayer previously claimed as a credit in [REDACTED]. No correlative adjustment was made for [REDACTED]. Thus, the Service erroneously allowed the taxpayer to claim foreign tax credits in not only [REDACTED] but also [REDACTED] for \$[REDACTED] of foreign income taxes paid or accrued in [REDACTED]. Subsequently, the taxpayer received a tentative carryback and refund adjustment pursuant to I.R.C. section 6411 for excess general business credits for the [REDACTED] tax year.

Our office has coordinated its review of this matter with the office of the Associate Chief Counsel's (International) to determine in which tax year to apply the foreign tax credit. Section 904(a) limits the amount of foreign income taxes that a taxpayer may claim as a credit in any taxable year to the taxpayer's pre-credit U.S. tax on its foreign source taxable

income for the taxable year. Section 904(c), in relevant part, provides that if the amount of a taxpayer's foreign income taxes for any year exceed the taxpayer's section 904 limitation for the year, the excess foreign income taxes are deemed to have been paid in the second year preceding taxable year, the first preceding taxable year and in the first, second, third, fourth and fifth succeeding taxable years in that order and to the extent not deemed paid in a prior taxable year.

Based on International's understanding from conversations with your office, it has been determined that the taxpayer's foreign income taxes for [REDACTED] does not exceed the taxpayer's section 904 limitation. Assuming this is correct, section 904(c) does not apply and the foreign income taxes paid or accrued for [REDACTED] are not deemed paid in [REDACTED]. Therefore, the taxpayer is not entitled to claim the \$ [REDACTED] of foreign income taxes paid or accrued in [REDACTED] as credits in [REDACTED]. Accordingly, the Service should offset the foreign tax credit in tax year [REDACTED], when the excess foreign tax was carried back and credited.

Section 6501(i) extends the period for assessing a deficiency that results from a carryback of excess foreign taxes under section 904(c). Section 6501(i) extends the period to assess the deficiency from a foreign tax carryback to one year after the expiration of the period within which a deficiency may be assessed for the taxable year that generated the excess taxes being carried back. In this case, the excess foreign taxes accrued in [REDACTED] but were carried back to [REDACTED]. The Service can assess the [REDACTED] deficiency, created by the erroneous 904(c) carryback of [REDACTED] excess foreign tax, for one year after the expiration of the assessment period for the [REDACTED] tax year. Accordingly, we look to the [REDACTED] tax year to determine if the period for assessment remains "open".

It is our understanding that the taxpayer received a tentative refund pursuant to I.R.C. section 6411 for excess general business credits for the [REDACTED] tax year although we do not know the dollar amount of this refund. Section 6501(k) extends the period for the Service to assess a deficiency where an amount has been applied, credited, or refunded under section 6411 by reason of a net operating loss carryback, a capital loss carryback or a credit carryback as defined in section 6511(d)(4)(C), which means any business carryback under section 39. This case involves a general business credit within the meaning of section 39.

Under section 6501(k) the Service can assess a deficiency for [REDACTED] up to the amount of the section 6411 tentative refund. Additionally, the assessment can arise from deficiencies unrelated to the general business credit carryback, such as the foreign tax credit, up to the amount of the refund under section

6411 less any deficiency assessment in [REDACTED] related to the general business credit. Furthermore, we believe that, under section 6501(i), tax year [REDACTED] is open to the extent that the foreign tax credit may be assessed for tax year [REDACTED]. Accordingly, it appears that the Service can assess the taxpayer for the [REDACTED] deficiency attributable to the erroneous foreign tax credit generated in [REDACTED] up to the amount of the [REDACTED] tentative refund based on carrybacks from [REDACTED] less the amount of any deficiency in [REDACTED] attributable to carryback of the general business credits.

Jamie G. Bernstein
Attorney-Advisor
CC:PA:APJP:B02
(202) 622-8471

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:LM:FSH:HAR:B:POSTF-108666-02
RMBoulanger

date: March 18, 2002

to: John Piucci, Team Coordinator (LMSB)

from: Raymond Boulanger, Attorney
Associate Area Counsel, CC:LM:FS:HAR:B

subject: [REDACTED]/Foreign Tax Credit Carryback

This memorandum is in response to your February 11, 2002 request concerning the above referenced matter.

Joint Committee Review - New York notified you that they disagreed with the statutory grounds upon which you wish to recapture from the taxpayer, a foreign tax credit generated in [REDACTED], but erroneously allowed in [REDACTED]. The taxpayer agrees with the recapture. As more fully set forth below, the statute of limitations is open for [REDACTED] by virtue of section 6501(k)¹, which permits the Service to apply offsetting issues for that year.

Issue

Whether the Service may recapture from the taxpayer a foreign tax credit generated in [REDACTED], but erroneously carried back and allowed in [REDACTED]. UIL No. 6501.01-01

FACTS

The taxpayer filed Form 1120X carrying back excess foreign tax credits from [REDACTED] to [REDACTED]. The credits were all sourced in the passive income basket. The 1120X for [REDACTED] was filed on [REDACTED] and carried back the excess credit of \$[REDACTED] as shown on the return.

Since the [REDACTED] examination was under the jurisdiction of the [REDACTED] Appeals office, the carryback was forwarded to them to be associated with their file. On [REDACTED] Appeals recommended that the carryback be allowed in full in [REDACTED]. The

¹ All statutory references are to the Internal Revenue Code in effect during the years at issue, unless otherwise noted.

carryback was reflected on the Appeals report for [REDACTED] dated [REDACTED]

Subsequently, Appeals prepared a report pertaining to the [REDACTED] examination. Based on the analysis of the foreign tax credit allowed in that report, it was determined that the credits that were available in [REDACTED] were not reduced to reflect the previously allowed carryback to [REDACTED]. Furthermore, no adjustment was made to the [REDACTED] report to account for the increased credit allowed in [REDACTED].

Therefore, the taxpayer was allowed the excess credit shown on the [REDACTED] return both as a carryback to [REDACTED] and as a current credit in [REDACTED].

The taxpayer filed a Form 1139 dated [REDACTED] relating to the tentative carryback under section 6411 for excess general business credits for the [REDACTED] tax year. The taxpayer received a refund as a tentative allowance. The refund was made before review by the Joint Committee on Taxation.

It is your position that the [REDACTED] statute is open by virtue of section 6501(j) which pertains to the general business credit carryback. As such you want to "piggyback" section 6501(i) for [REDACTED] and offset the erroneous foreign tax credit (generated in [REDACTED] but allowed in [REDACTED] against the general business carryback generated in [REDACTED] but allowed by way of tentative carryback to [REDACTED].

You have discussed this with the taxpayer and they agree with your position that they utilized foreign tax credits which they were not entitled to. They have signed a Form 870 for [REDACTED] through [REDACTED] tax years.

The case is presently with Joint Committee Review - New York. You have received from the reviewer a "case return transmittal" stating they disagree with the statutory grounds upon which you propose to recapture the foreign tax credit generated in [REDACTED] but erroneously allowed in [REDACTED]. The case return transmittal states the following:

RAR pages 142-144 cite I.R.C. §§ 6501(i) and 6501(j)(1) as allowing the recoupment of FTC allowed in [REDACTED]. I.R.C. § 6501(j)(2) defines the term "credit carryback" for purposes of this subsection as having the meaning given such term by I.R.C. § 6511(d)(4)(C). I.R.C. § 6511(d)(4)(C) says that "credit carryback"

means any business carryback under I.R.C. § 39. FTC is not covered by I.R.C. § 39.

If the [REDACTED] statute is not open, the special rules of I.R.C. § 1311 through 1314, covering mitigation appear to be usable since there is a "closed" year, [REDACTED], and an "open" year, [REDACTED]. [REDACTED] is considered open for foreign tax credit purposes since under I.R.C. § 6511(d)(3)(A), the [REDACTED] year has a 10 year statute of limitations for foreign tax credits, to [REDACTED]. The mitigation procedures would rectify the situation created by the double allowance of the foreign tax credit in both [REDACTED] and [REDACTED].

I received an e-mail from Chris Lappano early Thursday morning, March 14, 2002 informing me that an administrative deadline of "the opening of business on Tuesday, March 19, 2002" had been set regarding resolution of the entire case return transmittal. He had received that deadline earlier that same morning.

I then telephonically contacted you. You informed me that in order to prepare the necessary paperwork, agreements, etc. by the March 19, 2002 deadline, you had to have a response regarding this particular issue by early Friday afternoon, March 15, 2002. You also informed me that it is imperative that this deadline be met.

DISCUSSION

When a refund is granted under section 6411 by way of a tentative carryback claim, section 6501(k) permits the Service to assess a deficiency for the carryback on grounds not attributable to the carryback so long as the deficiency does not exceed the amount of the refund the taxpayer received, reduced by any amount of the deficiency actually attributable to the carryback. Pesch v. Commissioner, 78 T.C. 100 (1982). The portion of the deficiency attributable to carryback is assessable under section 6501(h) (if it is a net operating or capital loss carryback), and the balance of the deficiency up to the tentative refund amount is assessable under section 6501(k). Jones v. Commissioner, 71 T.C. 391, 396 (1978).

If the Internal Revenue Service subsequently disallows the tentative carryback, it has three remedies:

- ♦ Issue a notice of deficiency;
- ♦ Institute a civil suit to recover an erroneous

- ♦ refund (§ 7405); or
- ♦ Summarily assess the tax under § 6213(b)(3).

Pesch v. Commissioner, 78 T.C. 100, 117 (1982); Treas. Reg. § 301.6213-1(b)(2)(ii).

The summary assessment procedure is the same as that used to correct mathematical or clerical errors, except that the taxpayer does not have the right to force the Internal Revenue Service to abate the assessment. Section 6213(b)(3). The summary assessment procedure is limited, however, to items attributable to the carryback and cannot be applied to offsetting issues for the carryback year (which the Internal Revenue Service is permitted to raise by section 6501(k) under the ordinary deficiency procedures). See, Maxcy v. Commissioner, 59 T.C. 716 (1973); Leuthesser v. Commissioner, 18 T.C. 1112 (1952).

In the situation presented, the [REDACTED] tax year is "open" by virtue of section 6501(k). As such that section permits the Service to apply offsetting issues for the [REDACTED] carryback year.

The offset is predicated on your determination that the taxpayer was allowed foreign tax credits in excess of that shown on the [REDACTED] return as both a carryback to [REDACTED] and as a current credit in [REDACTED].

With respect to the procedures involved, you have stated that the taxpayer agrees with the Service that it was allowed excess foreign tax credits for the [REDACTED] tax year and is in agreement with the offset.

Therefore, it is recommended that you offset the general business credits with the excess foreign tax credit as set forth above.

We are simultaneously submitting this memorandum to the National Office for post-review and any guidance they may deem appropriate. Although you need to take immediate action, please note that the National Office may change this advice during the 10-day review period. We will inform you of any modification or suggestions, and, if necessary, we will send you a supplemental memorandum incorporating any such recommendation.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

CC:LM:FSH:HAR:B:POSTF-108666-02
RMBoulanger

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Since there is no further action required by this office, we will close our file in this matter ten days from the issuance of this memorandum or upon our receipt of written advice from the National Office, whichever occurs later. Please call Raymond M. Boulanger at (716) 551-5614 ext. (b)(6) if you have any questions or require further assistance.

BRADFORD A. JOHNSON
Associate Area Counsel
LMSB, Area 1

By: _____
RAYMOND M. BOULANGER
Attorney (LMSB)